

Message Text

PAGE 01 OECD P 06447 01 OF 02 141931Z

71

ACTION EUR-25

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LIMITED OFFICIAL USE SECTION 1 OF 2 OECD PARIS 6447

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SUBJECT: ANNUAL REVIEW OF SPAIN

REF: (A) USOECD 5221, (B) MADRID 1494, (C) MADRID
1505, (D) EDR(74)6, (E) FINANCIAL TIMES, 3/8.74

1. SUMMARY: EDRC REVIEW OF SPAIN MARCH 7 REVEALED
THAT SPAIN, LIKE OTHER COUNTRIES, IS FACED WITH
POLICY DILEMMA IN CHOOSING BETWEEN CONTROL OF RAPID
INFLATION AND MAINTENANCE OF OUTPUT AND EMPLOYMENT.
SPAIN HAS DECIDED IN FAVOR EMPLOYMENT AND IS TAKING
MEASURES STIMULATE ECONOMY WITH AIM TO ACHIEVE 5
PERCENT GNP GROWTH IN 1974. RESULTING INFLATION
MAY EXCEED 15 PERCENT. BALANCE OF PAYMENTS DEFICIT
ON CURRENT ACCOUNT EXPECTED REACH \$1.5 BILLION, TO
BE FINANCED BY DRAWDOWN RESERVES, FOREIGN BORROWING,
AND LONG TERM CAPITAL INFLOWS. SINCE SPANISH PRE-
SENTATION SOMETIMES IMPRECISE, REMARKS BELOW SHOULD
BE READ WITH REF B,C, AND 3 ABOVE. FINANCIAL TIMES
ARTICLE OF MARCH 8 IS ESPECIALLY USEFUL SUMMARY OF
SPANISH ECONOMY. END SUMMARY.

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PAGE 02 OECD P 06447 01 OF 02 141931Z

2. DEMAND AND OUTPUT: SPAIN VERY MUCH CONCERNED
RE DEFLATIONARY IMPACT ON DEMAND OF RECENT OIL PRICE
RISES. ADDITIONAL \$2.1 BILLION COST OF OIL IMPORTS
WILL CAUSE DROP IN GNP GROWTH RATE FROM EXPECTED 6.5

PERCENT TO 3.5 PERCENT IN 1974, WITH MAJOR IMPACT IN SECOND HALF. GOS CONSIDERS THIS RATE OF GROWTH UNACCEPTABLE AND IS TAKING MEASURES TO STIMULATE ECONOMY WITH AIM TO ACHIEVE 5 PERCENT GNP GROWTH, 8 PERCENT INCREASE IN GROSS FIXED INVESTMENT AND 5 PERCENT INCREASE IN PRIVATE CONSUMPTION.

3. POLICY MEASURES: SPANISH POLICIES PLACE CLEAR EMPHASIS ON GROWTH AND EMPLOYMENT RATHER THAN CONTROL OVER INFLATION. MEASURES TO STIMULATE ECONOMY INCLUDE 7 PERCENT INVESTMENT CREDIT TO BUSINESS AND POSTPONEMENT OF INCREASES IN FIRM'S SOCIAL SECURITY CONTRIBUTIONS. IN ADDITION GOVERNMENT WILL SPEND UP TO 10 BILLION PESETAS (\$166 MIL.) FROM CONUUNCTURAL ACTION FUND ON INFRASTRUCTURE PROJECTS, AND WILL SUPPLEMENT PUBLIC INVESTMENT PROGRAM BY ENCOURAGING PUBLIC ENTERPRISES TO BORROWING ABROAD. STIMULUS TO COMSUPTION WILL COME FROM SOCIAL ASSISTANCE FUND EXPENDITURES UP TO 3 BILLION PESETAS (\$50 MIL.), AND FROM REDUCTION IN TAX RATE ON IMPORTED OIL PRODUCTS AMOUNTING TO 30 BILLION PESETAS (\$500 MIL.). LATTER MEASURE ALSO INTENDED HOLD DOWN DOMESTIC OIL PROCE (PARA 6 BELOW).

4. SECRETARIAT (ANDERSEN) EXPRESSED SATISFACTION THAT SPAIN PLANNING FOLLOW GENERAL LINE OF SECRETARIAT RECOMMENDATIONS AT RECENT EPC MEETING, E.G. IMMEDIATE STIMULATION OF DEMAND TO OFFSET OIL INDUCED DEFLATIONARY GAP, COMBINED WITH PRICES AND INCOMES POLICY TO CONTROL INFLATION. BUT HE QUESTIONED SPANISH POLICY OF SUBSIDIZING DOMESTIC OIL PRICES, SINCE THIS WOULD NOT ENCOURAGE DESIRED REDUCTION IN OIL COMSUMPTION OR RELIEVE PRESSURE ON BOP. STIMULUS TO CONSUMER DEMAND SHOULD INVOLVE REDUCTION IN OTHER TYPES OF TAXES, NOTABLY CUSTOMS DUTIES WHICH WOULD HAVE SIMILAR EFFECT OF REDUCING LIMITED OFFICIAL USE
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PAGE 03 OECD P 06447 01 OF 02 141931Z

DOMESTIC PRICES AND WOULD ALSO CONTRIBUTE TO INCREASED COMPETITIVENESS. SPANISH DEFENDED SUBSIDY ON PETROLEUM PRODUCTS IN VIEW OF AMBITIOUS PLANS OFR AUTOMOTIVE INDUSTRY. ALSO POINTED OUT THAT ONLY 25 PERCENT OF OIL PRICE PASS-THROUGH WOULD BE SUBSIDIZED. OTHER DELEGATES CONCERNED THAT DETERIORATION IN BOP RESULTING FROM OIL TAX REDUCTION MIGHT DISCOURAGE IMPORT LIBERALIZATION IN OTHER AREAS. SPAIN NOTED THAT IMPORT LIBERALIZATION PROGRAM WAS CONTINUING, AND THAT FURTHER REDUCTIONS OF DUTIES WERE BEING CONSIDERED AS POSSIBLE ANTI-INFLATION MEASURE.

5. JAPANESE EXAMINERS AND SEVERAL OTHER DELS JOINED SECRETARIAT IN WELCOMING SPANISH DECISION TO STIMULATE ECONOMY. JAPANESE DEL EVEN SUGGESTED THAT SPAIN WAS NOT PLANNING STIMULATE CONSUMPTION ENOUGH, IN VIEW PLANNED STAGNATION REAL WAGES RESULTING FROM LINK BETWEEN WAGE AWARDS AND CIP GROWTH. SECRETARIAT NOTED THAT MAIN STIMULATION EFFORTS AIMED AT INVESTMENT AND THOUGHT THAT SPANISH GOAL OF 5 PERCENT INCREASE IN CONSUMPTION MIGHT BE DIFFICULT TO ACHIEVE UNDER PRESENT POLICIES. SPANISH DEL POINTED OUT THAT RECENT WEAKNESS IN SPANISH ECONOMY DUE TO SUPPLY CONSTRAINTS (PHYSICAL CAPACITY, MATERIALS, AND LABOR), NOT TO SHORTAGE CONSUMER DEMAND. CONSUMPTION BEING STIMULATED BY OIL TAX REDUCTION, AND SAVINGS RATION ALSO EXPECTED FALL 1.5 PERCENT.

6. US DEL TOOK OPPOSITE TACK, SUGGESTING THAT STRONG STIMULUS TO EXPANSION MIGHT BE PREMATURE AND HAVE DISASTEROUS IMPLICATIONS FOR INFLATION. HE NOTED LARGER COUNTRIES AT EPC WERE EXPECTING RECOVERY THEIR ECONOMIES IN SECOND HALF 1974, WHICH WOULD PROVIDE STIMULUS TO SPANISH EXPORT DEMAND, TOURIST RECEIPTS, AND WORKERS' REMITTANCES. SPANISH DEL REPLIED THAT GOS MEASURES WERE CAREFULLY BALANCED TO AVOID BEING EITHER TOO STRONG OR TOO WEAK.

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PAGE 01 OECD P 06447 02 OF 02 141940Z

71

ACTION EUR-25

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LIMITED OFFICIAL USE SECTION 2 OF 2 OECD PARIS 6447

7. PRICES AND WAGES: CONSUMER PRICES EXPECTED RISE 14 TO 15 PERCENT IN 1974 (DECEMBER ON DECEMBER) AFTER ADDING 3 PERCENT FOR OIL PRICE RISES. MAJOR INCREASE WILL COME IN FIRST HALF 1974 WITH LEVELLING

OFF IN SECOND HALF. OIL TAX REDUCTION EXPECTED SOFTEN IMPACT ON DOMESTIC PRICES, AND PRICE CONTROLS INTRODUCED LAST NOVEMBER ARE ALREADY TAKING EFFECT. WAGES ALSO SUBJECT TO CONTROL AND EXPECTED TO RISE BETWEEN 14 AND 19 PERCENT IN 1974. THESE CONTROLS LIMIT INCREASES TO RISE IN CPI, BUT EXCAPE CLAUSE PERMITS EXTRA 5 PERCENT WAGE HIKE IF EMPLOYERS DO NOT PASS THROUGH TO CONSUMERS. FINANCIAL TIMES ARTICLE NOTES THAT ACTUAL WAGE AGREEMENTS NOW RUNNING CLOSE 19 PERCENT AND EMPLOYEES SHOWING LITTLE RESISTANCE TO EXTRA 5 PERCENT. SECRETARIAT SUGGESTED THAT WAGE CONTROLS, IF SUCCESSFUL, WOULD CAUSE STAGNATION IN REAL INCOMES AND UNDERMINE GOS EFFORTS STIMULATE DEMAND. BUT IF NOT SUCCESSFUL, THEY WOULD GIVE FURTHER IMPETUS TO INFLATION. FOURTEEN PERCENT INCREASE IN CPI SEEMED TO BE MINIMUM POSSIBLE FOR 1974. US DEL NOTED THAT EFFECTS OF LARGE BUDGET DEFICIT, CONTINUED PRESSURE ON RESOURCES, AND UNCERTAIN PROSLIMITED OFFICIAL USE LIMITED OFFICIAL USE

PAGE 02 OECD P 06447 02 OF 02 141940Z

PECTS FOR WAGE RESTRAINT WOULD ALL CONTRIBUTE TO HIGH RATE INFLATION.

8. BALANCE OF PAYMENTS: GOS SLIGHTLY MORE PESSIMISTIC THAN SECRETARIAT REGARDING BOP OUTLOOK, BUT NOT PARTICULARLY CONCERNED RE PROSPECTS FINANCING CURRENT ACCOUNT DEFICIT IN SHORT TERM. TRADE ACCOUNT DEFICIT EXPECTED BE \$6 BILLION AND CA DEFICIT SLIGHTLY MORE THAT \$1.5 BILLION 1974. EXPORTS EXPECTED INCREASE 18 PERCENT BY VALUE (8 PERCENT REAL TERMS), WHILE NON-OIL IMPORTS WILL INCREASE AT SAME RATE. INCOME FROM TOURISM WILL REMAIN STABLE IN MONEY TERMS, ALTHOUGH NUMBER OF TOURISTS MAY FALL. EMIGRANT REMITTANCES WILL REMAIN CONSTANT, BUT LITTLE LIKELIHOOD FURTHER EMIGRATION IN 1974. SPAIN NOT CONCERNED ABOUT POSSIBLE INABILITY EXPORT SURPLUS UNEMPLOYMENT SINCE PRESENT LEVEL UNEMPLOYED IS VERY LOW.

9. SPAIN INTENDS FINANCE CURRENT ACCOUNT DEFICIT PARTLY BY LONG TERM CAPITAL IMPORTS AMOUNTING TO \$900 MILLION, PARTLY BY BORROWING UP TO 300 MILLION FOR PUBLIC ENTERPRISES, AND PARTLY BY DRAWING DOWN RESERVES. BOP CONSIDERATIONS NOT EXPECTED CONSTRAIN GROWTH IN 1974. IN MEDIUM TERM SPAIN LOOKS TO INCREASED IMIGRANT REMITTANCES TO BALANCE CURRENT ACCOUNT. GELGIAN DEL EXPRESSED CONDERN THAT SPAIN SHOULD BE BORROWING ABROAD WHEN ITS RESERVE POSITION SO STRONG, AND NOTED EPC CONCLUSION THAT SUCH COUNTRIES SHOULD ALLOW RESERVES TO RUN DOWN. US DEL ASKED RE SPANISH DEL COULD NOT SPECIFY MEASURES TO BE TAKEN, BUT NOTED THAT SOMETHING

WOULD HAVE TO BE DONE TO OFFSET ENORMOUS OIL DEFICITS.
HE DID NOT REPLY TO SUGGESTION THAT EXPORT PRO-
MOTION MEASURES MIGHT BE AT EXPENSE OF TRADING
PARTNERS WHO ARE SUFFERING FROM SIMILAR BOP PROBLEMS.

10. PUBLIC FINANCE: SPANISH DEL OBJECTED IN GENERAL
TERMS TO SECRETARIAT CONCLUSIONS THAT PUBLIC SECTOR
ACTIVITIES SHOULD BE INCREASED AND FISCAL REFORMS
CARRIED OUT. HE PROPOSED DISCUSS SUBJECT BI-
LATERALLY WITH SECRETARIAT, BUT NOTED THAT STRUCTURAL
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PAGE 03 OECD P 06447 02 OF 02 141940Z

ROLE OF PUBLIC SECTOR DEPENDED IN PART ON FISCAL
POLICY REQUIREMENTS, AND THAT FISCAL REFORM WAS
CONSTANTLY UNDER CONSIDERATION BY GOS.
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